NOSSAMAN LLP

Valuation Issues in a Depressed Market: How Market Conditions Impact Eminent Domain Practitioners

MARCH 24, 2009

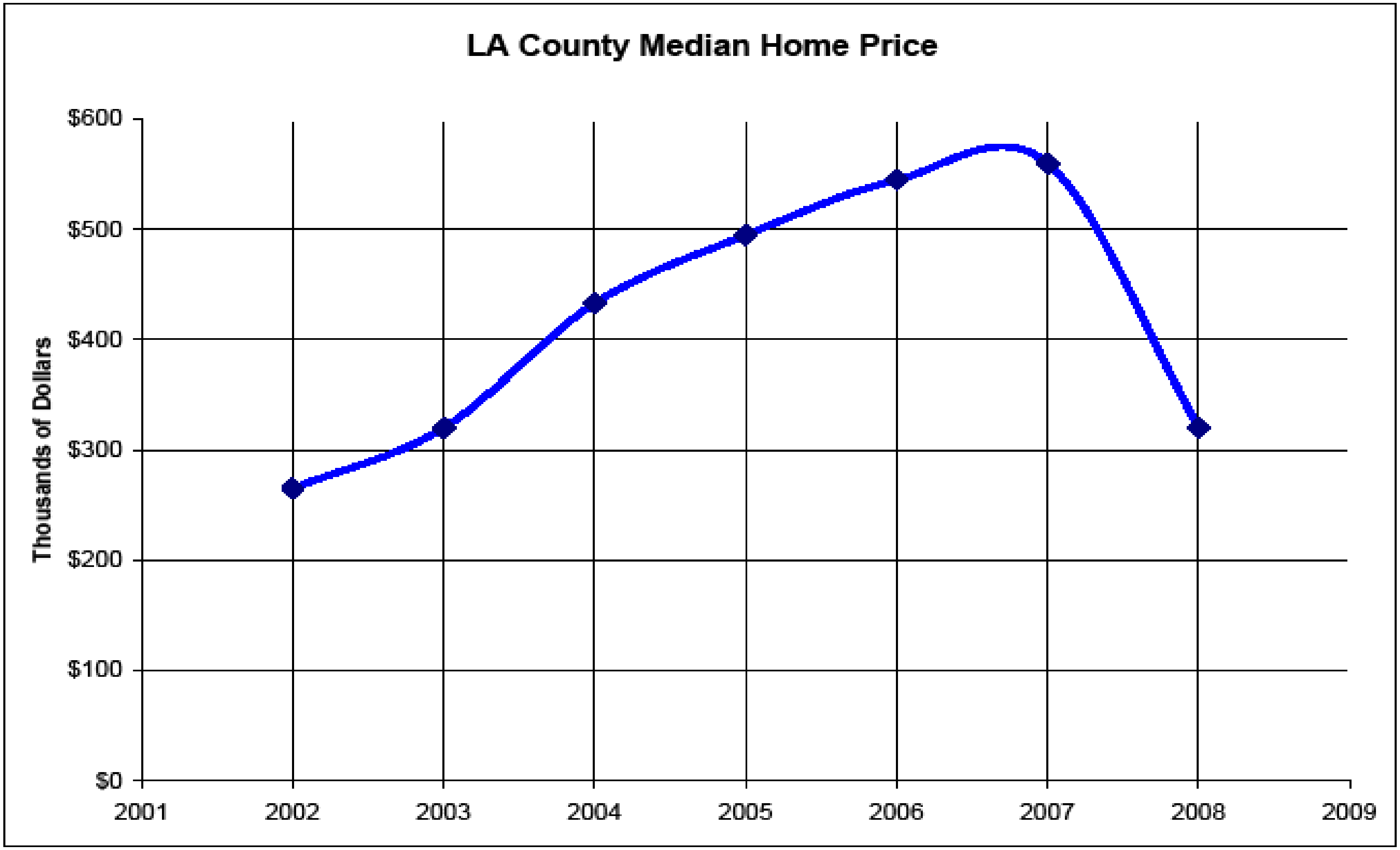
nossaman.com

MAKING IT HAPPEN.

How did this Program Come About?

- Questions in the Appraisal Community Concerning how Property Should be Valued in this Market & Whether Unique Eminent Domain Rules Change Traditional Fair Market Value Theories
- Agencies & Relocation Consultants Struggling to Figure out What to do When Condemnee is in Negative Equity Position

The Market – a Big Picture View



MAKING IT HAPPEN.

Market Participants

- Brokers
- Appraisers
- Right-of-Way Agents
- Relocation Consultants
- Bloomberg Quote on Foreclosures

Fair Market Value

- Just Compensation is defined as “fair market value”
- Fair Market Value is defined by California law, using a definition unique to Eminent Domain
- Appraiser must use the correct Fair Market Value definition or risk being excluded from trial, even if definitional difference would not change appraiser’s conclusion of value
- Code of Civil Procedure section 1263.320 requires appraisers to use the “highest” price, as opposed to “most probable” price

Fair Market Value Definition

The fair market value of the property taken is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for doing so, each dealing with the other will full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.

Fair Market Value Defined, Part B

The fair market value of property taken for which there is no relevant, comparable market is its value on the date of valuation as determined by any method of valuation that is just and equitable.

Condemnation in a Rising Market

MAKING IT HAPPEN.

A Simple SFR Condemnation

1. In a typical single-family home acquisition, condemnee generally put in a relatively good position
2. Gets full fair market value for the house
3. Gets relocation benefits, including assistance with loan closing costs
4. Eligible for a “Purchase Price Differential” (PPD) payment to ensure ability to purchase comparable replacement housing

An Example

- 3 bedroom,
  2 bath house
- 2,200 square feet
- FMV of $585,000
- 1st TD of $410,000
- HELOC of $25,000
- Owner Equity of $150,000

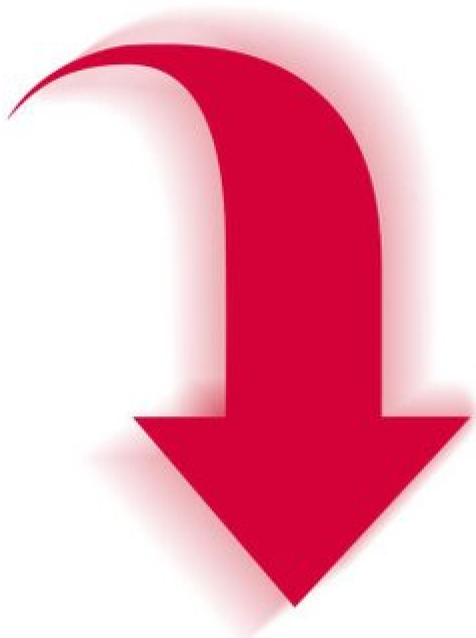
MAKING IT HAPPEN.

The Replacement House

- On the Market for $600,000
- Owner receives $15,000 PPD payment
- Puts $120,000 down (20%)
- Agency pays closing costs
- Owner retains $45,000 in cash

MAKING IT HAPPEN.

Condemnation in Today's Market



SFR Condemnation Today

1. Today, condemnee likely to have little or no equity
2. Under traditional fair market value principles, condemnee will receive no money
3. With no money, purchasing replacement housing difficult, if not impossible
4. Condemnee may remain liable for shortfall on existing loans
5. Condemnee's credit likely to be impacted by forced sale for less than loan balance

An Example: Today's Market

- 3 bedroom,
  2 bath house
- 2,200 square feet
- FMV of $350,000
- 1st TD of $410,000
- HELOC of $25,000
- Owner in an $85,000 Negative Equity Position

The Replacement House: Today

- Ample housing available at or below $350,000
- Owner receives NO PPD payment
- Entire Agency payment goes to lender
- Owner may still be liable for $85,000 negative equity

MAKING IT HAPPEN.

Fair Market Value, Part B Revisited

The fair market value of property taken for which there is no relevant, comparable market is its value on the date of valuation as determined by any method of valuation that is just and equitable.

Fair Market Value, Part B

- Is there a “relevant, comparable market” when market depressed, and most transactions are distressed?
- Is it “just and equitable” to take owner’s loan position into account in valuing the property?
- Does “replacement cost” analysis that takes into account owner’s financial position make sense?

PPD: A Closer Look

- PPD payment applies only to owner-occupied residence
- Payment capped at $22,500
- Calculated as “the amount, if any, which, when added to the acquisition cost of the dwelling acquired by the public entity equals the reasonable cost of a comparable replacement dwelling.”

PPD: A Closer Look

- Payment can also include increased loan costs:
  - The amount, if any, which will compensate the displaced owner for any increased interest costs which the owner is required to pay for financing the acquisition of a comparable replacement dwelling.
  - Reasonable expenses incurred by the displaced owner for evidence of title, recording fees, and other closing costs incident to the purchase of the replacement dwelling, but not including prepaid expenses.
- Total payment still subject to the $22,500 cap.

PPD: Avoiding the $22,500 Cap

- Government Code section 7272.3:

  > "This chapter shall not be construed to limit any other authority which a public entity may have . . . to make any relocation assistance payment in an amount which exceeds the maximum amount for such payment authorized by this chapter."

- Potentially provides a basis for exceeding the $22,500 cap, as long as the condemning agency has some "authority" for doing so.

PPD: Avoiding the $22,500 Cap

- Last Resort Housing Plan (Government Code section 7264.5):
  - "No person shall be required to move from his or her dwelling because of its acquisition by a public entity, unless comparable replacement housing is available to the person."
  - "If a . . . project undertaken by the public entity cannot proceed on a timely basis because . . . comparable replacement housing cannot otherwise be made available, the public entity shall take <u>**any action necessary**</u> or appropriate to provide the dwellings by use of funds authorized for the project."

Last Resort Housing

The methods of providing replacement housing of last resort include, but are not limited to . . . the purchase of land and/or a replacement dwelling by the displacing agency and subsequent sale or lease to, or exchange with a displaced person.

Last Resort Housing: Questions

- Can Agencies use these provisions to solve owner's negative equity problem?
- Does it matter whether owner's existing loan is recourse or non-recourse?
- Tax Implications?
- Is solving negative equity problem part of Just Compensation, or is it better characterized as a Gift of Public Funds?

A Hurdle: Gift of Public Funds

- The government "shall [not] have power to make any gift or authorize the making of any gift, of any public money or thing of value to any individual, municipal or other corporation."
  (Cal. Const., art. XVI, § 6.)
- But, expenditures of public funds which involve a benefit to private persons do not qualify as gifts if those funds are expended for a "public purpose." (*California Employment Stabilization Com. v. Payne* (1947) 31 Cal.2d 210, 215.)

Practical Reasons for Paying More

- The Agency has self-interested reason to pay More than $22,500 where necessary to secure replacement housing.
- Agency must “assure that a person shall not be required to move from a dwelling unless the person has had a reasonable opportunity to relocate to a comparable replacement dwelling.”
  (Gov. Code 7261(c)(4).)
- This could provide grounds for challenging (or at least delaying) Agency’s right to prejudgment possession.

Non-Residential Properties

- Most of the Regulations discussed apply only to residential properties.
- PPD, Last Resort Housing, etc. cannot help solve negative equity positions for commercial or industrial properties.
- Left with Fair Market Value, Part B?

Other Practical Issues: The Deposit

Typically, Agency makes a “Deposit of Probable Compensation” at the Outset of Litigation. Accomplishes Two Things:

1. Provides Agency Authority to Seek Prejudgment Possession
2. Establishes the Date of Value

To Deposit or Not to Deposit

- If Agency needs Prejudgment Possession, must make a deposit.
- But, if Agency does not need possession, should agency forego deposit in search of a later date a value?
- Appears to be no legal preclusion to Agency's "playing the market," hoping for a later date of value with a lower value.
- Note: If case goes to trial within one year of filing, date of value is date of commencement of action, even without a deposit. (CCP § 1263.120)

MAKING IT HAPPEN.

How Much to Deposit

- Typically, deposit amount based on appraisal done for purposes of precondemnation offer
- Where offer appraisal is stale, value may be lower by the time agency deposits
- May want to update appraisal just before filing/making deposit

MAKING IT HAPPEN.

Ethical Obligations

- Representing a landowner comes with no divided loyalty, but on the Agency side, the rules are different
- Gov. Code, § 7267.5 -- prohibits coercive action by public entity
- *City of Los Angeles v. Decker* (1977) 18 Cal.3d 860 – agency lawyer must seek “impartial justice”
- *County of Santa Clara v. Superior Court* (2008) 161 Cal.App.4th 1140 – government representation must be “absolutely neutral”

Other Practical Issues: Timing

- Great time to Condemn
- If funds available, may want to advance acquisition schedule
- To avoid right-to-take issue, generally must be able to show reasonable probability that property will be put to public use within seven years (CCP § 1240.220)
- Be careful not to condemn for the purpose of condemning (*City of Stockton v. Marina Towers LLC* [February 13, 2009])

Questions?

Rick: rrayl@nossaman.com

David: dgraeler@nossaman.com

Syd: syd@dhmappraisal.com